

COMMISSIONER'S DIRECTIVE #14

DECEMBER, 2007

(Replaces Commissioner's Directive #14 dated August 1990)

DISCLAIMER: Commissioner's Directives are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information that is not consistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer. Therefore the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: Financial Institutions Tax

REFERENCE: IC 6-5.5

INTRODUCTION

The purpose of this Directive is to present an overview of the Indiana Financial Institutions Tax (FIT) which was originally enacted in 1989. This overview is intended to highlight the major areas of the law and promote a general understanding of its basic principles.

Any taxpayer taxable under IC 6-5.5 is exempt from Indiana's adjusted gross income tax.

The law extends Indiana's tax jurisdiction to both resident and nonresident financial institutions and to all corporate entities that transact the "business of a financial institution" in Indiana regardless of where such entity is domiciled.

IC 6-5.5 adopts an economic presence method for determining the jurisdictional basis for taxing nonresidents who conduct the business of a financial institution in Indiana.

DEFINITIONS

A. "Business of a financial institution" means the activities of a traditional financial institution, or any corporation which derives 80 percent of its income from making loans and extending credit.

If a transaction is treated as a lease for federal income tax purposes, the leasing transaction is not the economic equivalent of extending credit for purposes of the 80 percent test. However, for purposes of the 80 percent test, extending credit not only includes credit card operations, but also includes debit card, charge card and similar businesses.

B. "Taxpayer" means regulated financial institutions, their holding companies and the subsidiaries of either, as well as any other corporation (including entities taxed as a corporation under the Internal Revenue Code) organized under the laws of the United States, Indiana, another taxing jurisdiction or a foreign government, which is carrying on the business of a financial institution.

Taxpayers are differentiated on the basis of their resident or nonresident status. A resident taxpayer is a taxpayer which is commercially domiciled in Indiana and transacts the business of a financial institution in Indiana.

A nonresident taxpayer is a taxpayer which is not commercially domiciled in Indiana but transacts the business of a financial institution in Indiana. IC 6-5.5-3 establishes the rules for determining when the activities of nonresident corporations constitute transacting business in Indiana. A taxpayer is transacting business in Indiana for the purposes of the FIT when it satisfies any of the following eight tests:

- (1) maintains an office in Indiana;
- (2) has an employee, representative or independent contractor conducting business in Indiana;
- (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
- (4) regularly solicits business from potential customers in Indiana;
- (5) regularly performs services outside Indiana that are consumed within Indiana;
- (6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in IC 6-5.5-3-8(5), and result in receipts flowing to the taxpayer from within Indiana;
- (7) owns or leases intangible personal or real property located in Indiana; or
- (8) regularly solicits and receives deposits from customers in Indiana.

Only a portion of a nonresident taxpayer's income is subject to the FIT. The statute employs a single factor receipts formula to determine the percentage of the nonresident taxpayer's income which is taxable. The single factor receipts formula is derived by dividing the gross receipts attributable to transacting business in Indiana by the taxpayer's total receipts from transacting business in all taxing jurisdictions.

EXEMPTIONS AND EXCLUSIONS

Four specific types of corporations are exempted from the franchise tax:

- (1) Insurance companies subject to the tax under IC 27-1-18-2 or IC 6-3;
- (2) International banking facilities (as defined in Regulation D of the Board of Governors of the Federal Reserve System);
- (3) Any corporation that is exempt from income tax under Section 1363 of the Internal Revenue Code; and
- (4) Not-for-profit corporations.

An exclusion is also provided for those financial institutions whose Indiana activities are limited to certain activities. These activities include owning an interest in the following types of property, including those activities within

Indiana that are reasonably required to evaluate and complete the acquisition or disposition of the property, the servicing of the property or the income from the property, the collection of income from the property, or the acquisition or liquidation of collateral relating to the property:

- (A) An interest in a real estate mortgage investment conduit, a real estate investment trust, or a regulated investment company (as those terms are defined in the Internal Revenue Code).
- (B) An interest in a loan-backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments in relation to payments or reasonable projections of payments on the notes or certificates.
- (C) An interest in a loan or other asset in which the interest is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5 and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.
- (D) An interest in the right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5 and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.
- (E) An amount held in an escrow or a trust account with respect to property described in this subdivision.

COMBINED RETURNS

A taxpayer is allowed to file a separate return only in those instances where the taxpayer is not a member of a unitary group. If the taxpayer is a member of a unitary group, combined reporting is mandatory. However, if the taxpayer determines that its Indiana income is not accurately reflected by the filing of a combined return, then the taxpayer may petition the Department by indicating on its annual return, that the return is a separate return made by a member of a unitary group. Such petition is subject to approval by the Department.

If a combined return is warranted, each taxpayer which is a member of a unitary group is obligated to file as a part of the combined return which includes all operations of the unitary business, but the unitary group should

collectively file one return. The statute requires that the combined return include the adjusted gross income of all members of the group that are transacting business wholly or partially within Indiana. The statute provides an exclusion for the income of corporations or other entities organized in foreign countries, except a federal or State branch of a foreign bank or its subsidiary which transacts business in Indiana. In other words, combined reporting is on a waters edge basis.

“Unitary business” means business activities or operations that are of mutual benefit, dependent upon or contributory to one another, individually or as a group, in transacting the business of a financial institution. The term may be applied within a single entity or between multiple entities and without regard to whether each entity is a corporation, a partnership or a trust.

“Unitary group” means those entities that are engaged in a unitary business wholly or partially within Indiana. Unity is presumed if there is unity of ownership, operation or unity of use as evidenced by centralized management, centralized purchasing, advertising, accounting or other controlled interaction among entities that are members of the unitary group as defined in IC 6-5.5-1-18(a). In other words, members of a unitary group are limited to those members who meet the definition of “taxpayer” for purposes of IC 6-5.5.

Unity of ownership exists for a corporation if it is a member of a group of two or more business entities, 50 percent of whose voting stock is owned by a common owner or owners or by one or more of the member corporations of the group.

COMPUTATION

Taxpayers, with the exception of credit unions and investment companies, compute the FIT as follows:

Federal Taxable Income (I.R.C. Section 63)	_____
ADD:	
A. Deduction/losses included	_____
federal income tax return not	
allowed on the Indiana return:	_____
(1) Net operating losses (NOL)	_____
(2) Net capital losses	_____
(3) Bad debt deductions	_____
(4) Charitable contributions	_____
(5) State income and franchise	
taxes	_____
B. Interest income on state and	
municipal obligations not included	
in federal taxable income	_____
DEDUCT:	
A. Bad debts actually charged off	(_____)
B. Associated expenses to carry	
state and municipal obligations	
(I.R.C. Section 265)	(_____)
C. Bad debt reserve transition	
adjustment included in federal	
taxable income because of a tax	
accounting method change	(_____)
<u>Indiana Adjusted Gross Income</u>	=====
Apportionment factor:	
<u>Receipts attributable to Indiana</u>	
Total receipts	= _____ %
Indiana Apportioned Income	_____
DEDUCT:	
* Indiana net operating losses (NOL)	(_____)
**Indiana net capital losses	
(deductible to the extent of net	
capital gains)	(_____)
Indiana Taxable Income	_____
Tax Rate	X 8.5%
Tax before Credits	_____
*** Less: Nonresident taxpayers	
Credit	(_____)
Indiana Financial Institutions Tax Liability	=====

*Indiana's net operating loss (NOL) for the nonresident taxpayer is multiplied by the apportionment factor. If there is negative taxable income when the FIT income is determined, the same may be carried forward. Such carryforward may be carried forward 15 years. Losses are not carried back.

**A taxpayer's Indiana net capital loss for the taxable year equals the taxpayer's net capital losses for the taxable year minus the net capital gains for the year multiplied by the apportionment percentage applicable to the taxpayer under IC 6-5.5-2 for the taxable year of the loss. A net capital loss for a taxable year may be carried forward to each of the 5 succeeding taxable years.

***^(a) A nonresident taxpayer is entitled to a credit against the tax due under this article for the amount of net income tax due to the nonresident taxpayer's domiciliary state for a taxable year if:

- (1) the receipt of interest or other income from a loan or loan transaction is attributable both to the taxpayer's domiciliary state under that state's laws and also to Indiana under IC 6-5.5-4; and
 - (2) the principal amount of the loan is at least \$2,000,000.
- ^(b) The amount of the credit for each taxable year is the lesser of:
- (1) the portion of the net income tax actually paid by the nonresident taxpayer to its domiciliary state that is attributable to the loan or loan transaction; or
 - (2) the portion of the FIT due to Indiana under this article that is attributable to a loan or loan transaction. The amount of tax attributable to a loan or loan transaction is the portion of the total tax due to each state in an amount equal to the same proportion as the receipts from the loan or loan transaction bear to the taxpayer's total receipts.

In the case of a nonresident credit union, "adjusted gross income" for a taxable year means the total transfers to undivided earnings minus dividends for that taxable year after statutory reserves are set aside under IC28-7-1-24, multiplied by their apportionment factor.

In the case of a nonresident investment company, "adjusted gross income" means the company's federal taxable income multiplied by the quotient of:

1. the aggregate of the gross payments collected by the company during the taxable year from old and new business upon investment contracts issued by the company and held by a resident of Indiana; divided by
2. the total amount of gross payments collected during the taxable year by the company from the business upon investment contracts issued by the company and held by persons residing within Indiana and elsewhere.

PAYMENT OF THE TAX

The FIT is payable directly to the Department. Quarterly estimated payments are required if the taxpayer's annual liability exceeds \$2,500. If the taxpayer's quarterly estimated payments exceed \$5,000, the estimated payment must be made by electronic funds transfer.

A handwritten signature in black ink that reads "John Eckart". The signature is fluid and cursive, with a large loop at the beginning of the "J" and a stylized "Eckart".

John Eckart
Commissioner